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IN THE

Supreme Court of the United States

OCTOBER TERM, 1935
No. 643

THE UNITED STATES OF AMERICA,
Petitioner

vs.

W. V. KNOTT, as State Treasurer and Ex-Officio Insurance Commissioner of the State of Florida, and NEW JERSEY FIDELITY AND PLATE GLASS INSURANCE COMPANY,
Respondents

CERTIORARI TO THE SUPREME COURT OF FLORIDA

BRIEF OF RESPONDENTS, W. V. KNOTT, STATE TREASURER AND EX-OFFICIO INSURANCE COMMISSIONER OF THE STATE OF FLORIDA, AND OF D. M. LOWRY, RECEIVER IN THE STATE OF FLORIDA, OF THE NEW JERSEY FIDELITY AND PLATE GLASS INSURANCE COMPANY

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THE OPINION OF THE COURT BELOW

The opinion of the Supreme Court of Florida, under date of June 24, 1935, is reported in 163 Southern Reporter, 64, under the style of Kelly, Commissioner of Banking and Insurance, et al, vs. Knott, State Treasurer, et al—and London Operating Company vs. New Jersey Fidelity & Plate Glass Insurance Company, et al, and appears at pages 347-356 of the Record. The order of the Leon County Circuit Court, from which the appeal was taken (Record 253-254) is not officially reported.

STATEMENT

The New Jersey Fidelity and Plate Glass Insurance Company, a New Jersey Corporation, in 1930 deposited securities of the face value of Seventy-five Thousand ($75,000.00) Dollars with the Treasurer of the State of Florida, in accordance with Section 6302 and Section 6303, Compiled General Laws of Florida, in order to qualify to transact the business of a surety company in that State. On May 28, 1932, the Surety Company was placed in the hands of the Commissioner of Banking and Insurance of the State of New Jersey. On May 17, 1933, D. M. Lowry was appointed Receiver in the State of Florida, of all assets of the said Surety Company, under the authority of Chapter 16248, Acts of 1933, the same being amendatory of Section 6303, Compiled General Laws of Florida, supra. The State Treasurer, pursuant to Court order, turned over the securities to the Florida Receiver. The United States filed twenty (20) separate claims, aggregating $14,075.00 (Rec. 157-163; 165-166). The printed record sets out Claim #14 in full. The other nineteen (19) claims are merely recited, (Rec. 293-295) but the recited claims are in substantially the same form and verbiage as Claim #14.

Each claim of the United States arose out of an appearance, or bail, bond executed in a criminal case by the defendant with the United States as obligee. Upon the failure of the defendant to appear for trial the several bail bonds were estreated and judgment later entered thereon.

These judgments remained unpaid for more than thirty (30) days, whereupon, certified copies of the judgments were filed with the Treasurer of Florida, together with notices that the Surety Company had failed to pay the judgments. The filing of the certified copies of the judgments, and the giving of the notices of their non-payment, was in accordance with Section 6303, Compiled General Laws of Florida. Numerous claims, arising out of surety bonds, were filed by citizens of Florida, who largely were obligees in surety bonds.

The Circuit Court of Leon County, Florida, on the 28th of May, 1934 (Rec. 199-201) held, that the securities were deposited by the Surety Company with the State Treasurer for the protection of the State of Florida, its citizens and political subdivisions; that the securities were segregated and set apart out of the general assets of the Surety Company prior to the accrual of any liens of, or obligations to, the United States; that the Legislature of Florida in enacting the legislation requiring such deposit did so with the intention of protecting those whom it had the power and duty to protect; that the deposit with the State Treasurer constituted a trust fund for the benefit of the State of Florida, its political subdivisions and its citizens; that the United States was not a beneficiary of said trust fund; that the beneficiaries of said trust fund, to-wit: the citizens and political subdivisions of the State of Florida, were first entitled to be paid out of the trust fund; and

that any surplus remaining thereafter would become general assets of the Surety Company, and under Section 191, Title 31 of the U. S. C. A. (Sec. 3466 Revised Statutes), the United States would have the prior right to participate in such surplus. No appeal was taken from the above order.

On October 27, 1934, the Circuit Court of Leon County ordered the claims of Florida citizens and political subdivisions paid by the Receiver, but reserved the question of whether or not the claims of the United States should be paid by the Florida Receiver out of the residue, or whether it should be transmitted to the domiciliary liquidator for payment, and in said order reciting that "sufficient funds would remain in the hands of the Receiver, after the payment of Florida creditors, to pay the claims of the United States, and that the payment thereof would 'in nowise prejudice the United States' " (Rec. 253-254).

An appeal was taken from this order of October 27, 1934, by Wm. H. Kelly, Commissioner of Banking and Insurance of the State of New Jersey. (Rec. 255-256). Cross assignments of error were filed by the United States (Rec. 303-304) in the Kelly appeal, wherein the assignments of error were directed to the order of October 27, 1934, and the order of August 7, 1934, but no assignments of error were directed to the order of May 28, 1934. Neither the appeal of Wm. H. Kelly, nor the cross appeal by the United States brought up for consideration the order of May 28, 1934, nor the order of August 7, 1934 (Rec. 235-239).

After an amendment of its claims on November 17, 1934 (Rec. 297-298-299), the United States again amended its claims (Rec. 300-303). (The date of which amendments is not shown by the record, but the jurat thereto, on page

302 of the Record, shows that they were sworn to on the 13th day of December, 1934.) The amendments, therefore, were made after the order of October 28, 1934, and after the entry of the appeal on the 5th of November, 1934. The earliest judgment among the claims of the United States was entered on September 15, 1932, being Claim #25 (Rec. 295). Six of the judgments were rendered in 1932, but none earlier than September 15th of that year. Fourteen of the judgments were rendered during the year 1933 (Rec. 293-295). The deposit with the State Treasurer was made in 1930 (Rec. 311). All of the claims of the United States, therefore, accrued subsequent to the time the securities were segregated from the assets of the Surety Company and deposited with the State Treasurer.

The Supreme Court of Florida affirmed the decree of the Circuit Court of Leon County, Florida, holding in substance as follows:

(a) That neither the Constitution of the United States nor the Constitution of Florida prohibits the State from requiring a foreign surety company to make a special deposit with the State Treasurer to be held in trust for the benefit and security of Florida resident creditors;

(b) That the deposit so established created a trust fund;

(c) That the correct answer of the purposes of the deposit is "to be found in the necessary meanings and intendments comprehended within the scope of the language of the statute under which the deposit of securities were required to be made. Sec. 4339 Revised General Statutes; Sec. 6302 Compiled General Laws.";

(d) That Chapter 16248, Acts of 1933, was "merely declaratory of what was already the Florida law subject

to which the deposited securities were put up to be held, subjected or distributed, as occasion might arise.";

(e) That the fund represented by the deposited securities, is also in the nature of a fund held in trust for the benefit of domestic creditors of the depositing surety company, as a condition precedent to its right to transact a surety business in this State;

(f) That it was competent for the Legislature of 1933 to enact Chapter 16248, setting up a special chancery proceeding by which the trust could be enforced and discharged in the event of the depositor's insolvency;

(g) That neither Section 6302, Section 6303 Compiled General Laws, or Chapter 16248, Acts of 1933 comprehend that claims or judgments recovered by the United States shall be within the purview of the trust purposes provided for by said Sections, since the Legislature of Florida was presumed to have enacted its protective legislation for the benefit of Florida claims arising out of the corporation's transaction of business in Florida, and to have provided for the creation of this special trust fund deposit for their particular benefit.

(h) That in view of legislation by Congress for the protection of the United States in the matter of the issuance of surety bonds, the United States cannot rely upon the Florida statutes with reference to its surety bonds;

(i) That the Federal priority statute, Sections 191 and 192, Title 31 U. S. C. A., is operative against the general assets of the surety company in the hands of the domiciliary liquidator, or against the residue of the special Florida deposit after the satisfaction of Florida claims.

QUESTIONS PRESENTED

I. A Foreign Surety Company segregated, set aside and deposited with the State Treasurer of the State of Florida securities in the Amount of Seventy-five Thousand Dollars ($75,000.00) in conformity with the requirements of State Statutes. Subsequently the Surety Company executed certain penal obligations, or appearance bonds, with the United States as obligee. Upon the insolvency and receivership of the Surety Company the following questions arise relative to the distribution of the proceeds of the sale of such securities as between the United States and residents of Florida:

(a) Does such a deposit constitute a trust fund?

(b) If the deposit is a trust fund who are the benificiaries, and in the absence of a definite statutory designation of beneficiaries how shall they be determined?

(c) Does the right to participate in such trust fund depend upon the construction of the statute creating the trust fund, or does it depend upon the construction of the Federal Priority Statute (Sec. 191 Title 31 U. S. C. A.; Sec. 3466 RS)?

(d) If the deposit created a Statutory Trust Fund prior to the accrual of the obligations to the United States could such trust fund be violated by resort to the Federal Priority Statute?

(e) May a Federal Collection Statute abrogate, or set at naught, a State Statute enacted in the exercise of the Police power of the State?

(f) Where Congress has prescribed the conditions upon which a surety company may be accepted

as surety on surety bonds running to the United States, can the Federal government rightfully rely upon State Statutes prescribing the conditions upon which surety companies may write bonds within that State, to the end that the protection designed by the State Statute for the citizens of that State, might be wholly consumed by the Federal government?

(g) Since the Federal Government's right of priority is wholly Statutory, must not the allegations in the claims of the United States be such as to bring such claims within the protection of the Federal Priority Statute?

SUMMARY OF ARGUMENT

(a) That the deposit with the State Treasurer constituted a trust fund for the protection of those for whom the State had the power and duty to legislate, to-wit: The State of Florida, its political sub-divisions, and its residents, the sole beneficiaries of said trust.

(b) That the statute requiring a surety company to make such a deposit is a valid exercise of the police power of the State.

(c) That the right to participate in such trust fund depends upon the construction of the State statute creating the trust fund, and not upon the Federal priority statute, and, therefore, no Federal question of substance is involved.

(d) That the deposit creating the trust fund was made by the segregation of the securities from the general assets of the surety company prior to the accrual of the obligations to the United States, and that even if the priority

statute be invoked, such priority statute would not abrogate, nor affect, the rights of the cestuis que trust in the fund.

(e) That a Federal collection statute cannot set at naught a valid State statute enacted in the exercise of its police power.

(f) That Congress has enacted its own legislation for the protection of the United States against the insolvency of surety companies, and the United States, therefore, cannot take advantage of State statutes enacted for the purpose of protecting the State and its citizens to the prejudice of the State and its citizens. The fact that Congress has enacted legislation prescribing the terms and conditions upon which a surety company may become surety on a bond running to the United States is conclusive evidence of the fact that the United States was not intended to be made a beneficiary of the trust fund by the State.

(g) That the United States' right of priority depends entirely upon the Federal priority statute rather than upon its general powers of sovereignty, and that in order for the claims to come within the protection of the priority statute it was necessary that the allegations of the claims bring the same within the provisions of the priority statute.

ARGUMENT

A foreign surety company segregated, set aside, and deposited with the State Treasurer of the State of Florida securities in the amount of Seventy-five Thousand ($75,000.00) Dollars, in conformity with the requirements of State statutes. Subsequently, the surety company executed certain penal obligations, or appearance bonds, with the United States as obligee. Upon the insolvency and receivership of the surety company the following questions arise relative to the distribution of the proceeds of the sale of such securities as between the United States and residents of Florida;

Question (a): Does such a Deposit Constitute a Trust Fund?

An affirmative answer to this question has been given by this Court in BLAKE vs. McCLUNG, 172 U. S. 239; 19 Sup. Ct. 165, wherein the Court said:

> "It may be appropriate to observe that the objections to the statute of Tennessee do not necessarily embrace enactments that are found in some of the states requiring foreign insurance corporations, as a condition of their coming into the State for purposes of business, to deposit with the State Treasurer funds sufficient to secure policy holders in its midst. Legislation of that character does not present any question of discrimination against citizens forbidden by the

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Note: (Because of the shortness of time for preparing, printing and filing briefs before oral argument, this brief has been prepared prior to the receipt of the brief of the Solicitor General of the United States, and, therefore, is not a reply to the arguments which will therein be made.)

Constitution. *Insurance funds set apart in advance for the benefit of home policy holders of a foreign insurance company doing business in the state are a trust fund of a specific kind to be administered for the exclusive benefit of certain persons.* Policy holders in other states know that those particular funds are segregated from the mass of property owned by the company and that they cannot look to them to the prejudice of those for whose special benefit they were deposited." (Italics supplied).

The Supreme Court of Florida, in the decision hereunder review—Kelly vs. Knott, 163 So. 64,—held that the said deposit was "a statutory trust fund created by the act of deposit in accordance with the Florida statute"; also— "—the fund represented by the deposited securities is also in the nature of a fund held in trust for the benefit of domestic creditors of the depositing surety company, as a condition precedent to its right to transact a surety business in this State."

The Circuit Court of Leon County, Florida, (Rec. 200) held:

> "— which fund the Court believes was a trust fund for the sole protection of the State of Florida, its political sub-divisions and its residents, or citizens."

This Court has repeatedly held statutes, requiring similar deposits, to be valid. McGoon vs. Scales (9 Wall), (U. S. 23), 19 L. Ed. 545 (text Pg. 548); Paul vs. Virginia, (8 Wall), (U. S. 168), 19 L. Ed. 357.

Question (b): If the Deposit is a Trust Fund Who are the Beneficiaries, and in the Absence of a Definite Statutory Designation of Beneficiaries How shall They be Determined? (Prefatory portion of question omitted.)

Ordinarily, in determining who the cestuis que trustent are in any instrument creating a trust, resort would first be had to such instrument. In the instant case, the statutes of Florida, Section 6302, Compiled General laws, requiring the deposit by the surety company, as a condition upon which the surety company could transact a surety business, is the instrument creating the trust under consideration. Of course, in a statute of this nature no beneficiary is specifically named. The statute deals with beneficiaries as a class. But the statute had a purpose. In order, therefore, to determine who the beneficiaries are in this statutory trust, it is necessary to consider the purpose and intent of the statute under which the trust was created and established. For whose benefit and protection was the statute enacted? Our answer is that the statute had for its purpose the protection of those for whom the State had power and duty to legislate. It was enacted in the exercise of the police power of the State, for the welfare, safety and security of the State, its political sub-divisions and its citizens. The State of Florida had no power to legislate in behalf of the State of Georgia, for instance, nor in behalf of its citizens. If it had no such power it certainly had no duty to legislate for the benefit and protection of the sovereign State of Georgia, nor the citizens thereof. By the same reasoning, it had no power, nor duty, to legislate in behalf of the National Sovereign. The United States had its own legislative body, whose laws, within the scope of its legislative power, were supreme, before which contrary laws of the State, upon the same subject matter, must give way.

Congress by Sections 1 to 11, inclusive, of Title 6 of U. S. C. A., had provided the conditions upon which a surety company might write surety obligations in favor of the Federal Government. For instance:

Section 6, Title 6, U. S. C. A., permits the giving of a surety bond.

Section 7, Title 6, U. S. C. A., provides that a surety company giving a bond must appoint a resident agent upon whom process may be served.

Section 8, Title 6, U. S. C. A., requires every surety company, before transacting surety business, to deposit with the Secretary of the Treasury copy of its charter, statement signed by its president and secretary, and must have $250,000.00 paid up capital, and the Secretary of the Treasury must grant authority to the surety company to write bonds.

Section 9, Title 6, U. S. C. A., requires each surety company to file quarterly statements with the Secretary of the Treasury and gives the Secretary of the Treasury the right to revoke the authority of any surety company to transact business and to require additional security to be put up when the Secretary of the Treasury deems such company no longer sufficient security.

Section 10, Title 6, U. S. C. A. provides for suits against such surety companies.

Section 11, Title 6, U. S. C. A. provides that upon the failure to pay any final judgment the company shall forfeit its right to write surety bonds for the Federal Government.

It was, therefore, entirely immaterial to the Federal Government whether or not the surety company had quali-

fied according to the laws of Florida to transact business within that State. It is also true that if Florida had undertaken to prescribe the conditions upon which a surety company could have written surety bonds with the United States as obligee, such an effort would have been both futile and ludicrous.

From the above considerations we reach the conclusion that the State had neither the power, nor duty, to legislate in behalf of the United States, and since it had the power and duty only to legislate in its own behalf, and in behalf of its political subdivisions and citizens, these are the only beneficiaries of the trust fund. From this, it seems to follow, that the United States is not a beneficiary, and *as such* is not entitled to participate in the proceeds derived from the sale of the deposited securities.

The decision of the Supreme Court of Florida here in question, (Kelly vs. Knott, 163 So. 64), said:

> "Neither does Section 6302 Compiled General Laws, 4339 Revised General Statutes, Section 6303 Compiled General Laws, 4340 Revised General Statutes, or Chapter 16248, Acts of 1933, comprehend that claims or judgments recovered by the United States of America shall be within the purview of the trust purpose provided for by said sections. The legislature of Florida *is presumed* to have enacted its protective legislation for the benefit of Florida claims arising out of the corporate transactions of business in Florida, and to have created this special trust fund deposit for their particular benefit."

Since the above is a construction of the State statute by the Supreme Court of Florida, it would seem that this construction would be conclusive, and that the United States is not a beneficiary under the Act, and whatever right to recover that it may have will be other than as a beneficiary in the trust fund.

Question (c): Does the Right to Participate in Such Trust Fund Depend Upon the Construction of the Statute Creating the Trust Fund, or does it Depend Upon the Construction of the Federal Priority Statute? See 3466 R. S. (Prefatory portion of question omitted.)

It will be borne in mind that the Florida Receiver had in his possession only the proceeds from the sale of the securities deposited with the State Treasurer. He had no general assets of the surety company.

We hope we have shown by decisions of this Court, and of the Supreme Court of Florida, that the funds were trust funds of a trust created by the Florida statute and its acceptance by the surety company. It is important to bear in mind that the deposit with the Treasurer was made long prior to the accrual of the claims of the United States. The proceedings were in a State court, against State agencies and officials, in reference to a State statutory fund, which could, under no circumstances, be reached even by a beneficiary except in conformity with the provisions of the State statute. From this state of facts, we are led to inquire, may a litigant claim benefits provided by a valid statute unless he claims under, and in conformity with, the provisions of the statute? or,—to apply the question to the instant case,—may the United States have participation in a valid statutory trust fund in complete disregard of the creative statute? The question seems to supply its own answer. Assuredly the litigant's rights must be determined by the construction and application of the statute creating and controlling the fund. If we are correct in this conclusion, then there is no Federal question involved in

this controversy, and the construction of the State statute, by the State Supreme Court, would be conclusive.

The Federal priority statute (Sec. 3466 R. S., 191 Title 31 U. S. C. A.), never comes into operation until and unless the trust has been executed and a residue remains. The residue of the trust fund, after the execution and discharge of the trust, would then become general assets on which the Federal priority statute would operate, provided, there existed, and were made known, facts which called the priority statute into operation.

The Circuit Court of Leon County, in the order of May 28, 1934 (Rec. 198-201, text 200) decreed:

> "The Court is of the further opinion that after all claims arising out of surety bonds and surety contracts held and proven by residents of Florida, political subdivisions of Florida, of the State of Florida, shall have been paid by the Receiver, and that there should then remain a surplus in the hands of said Receiver, that such surplus would thereupon become general assets of said surety company, and that under Section 191, Title 31, of the United States Code, Annotated, the United States Government would then have the prior right to participate in such surplus - - - - "

In the order appealed from, under date of October 27, 1934, (Rec. 253-254), the Circuit Court of Leon County, Florida, said:

> " - - - since it appears that sufficient funds will remain in the hands of the said Receiver after (for) the payment of all claims of the United States - - -, therefore, the payment of the claims herein and heretofore allowed will in nowise prejudice the United States - - - "

The report of the Receiver (Rec. 248) shows that the total undisposed of claims, including the claims of the United States, amounted to $35,149.92, with estimated assets remaining of $38,491.99. The estimated assets were based upon the par value of the securities. However, the securities were sold at 110% of the par value (Rec. 252), so that the estimated remaining assets of $38,491.99 are in reality $45,591.99, as against the total remaining claims of $35,149.92.

The Supreme Court of Florida, in its opinion in this case, (Kelly vs. Knott, 163 So. 64) recognized the prior right of the United States to the general assets after the discharge of the trust. It said:

> "And in view of the provisions of the Federal Government's specially provided statutory rights under Sections 191 and 192, Title 31 U. S. C. A., as against the general assets of the insolvent surety company, enforcible against the general assets of the company in the hands of the domiciliary Liquidator, or out of any residue of the special Florida deposits, which may remain to be turned over to the domiciliary liquidator, as general assets, after the satisfaction thereout of Florida claims, it would do violence to the ordinary rules of statutory construction to now so construe the Florida statutes as to make them inure to the special protection of the United States, as well as Florida creditors."

We, therefore, submit:

(a) That the right of the United States to participate in the trust fund herein, as such, depends upon the construction of the Florida statute, and not the Federal priority

statute. See McGoon vs. Scales, 76, U. S. (9 Wall) 23; 19 L. Ed. 545; Beale Conflict of Laws—Vol. 2 pg. 964;

(b) That because of the Federal Government's own statutes for its protection, it is presumed not to be entitled to participate in the Florida trust fund prior to the fulfillment of the trust;

(c) That upon the execution of the trust and the discharge of the trust fund therefrom, the remaining assets then become general assets, in which the Circuit Court of Leon County, Florida, as well as the Supreme Court of Florida, recognized the prior right of participation by the United States;

(d) That the record shows that more than ample funds remain in the hands of the Florida Receiver to pay the claims of the United States in full;

(e) That in view of the holdings of the Circuit Court of Leon County, Florida, and the Supreme Court of Florida, as to the right of the United States to be paid out of the ample funds remaining in hand, there is no actual controversy before this Court, but only an abstract [redacted] question of law;

(f) That the writ herein is directed to a decree which was not final.

Question (d): If The Deposit Created a Statutory Trust Fund Prior to the Accrual of the Obligations to the United States Could such Trust Fund be Violated by Resort to the Federal Priority Statute? (Prefatory portion of question omitted.)

The deposit with the State Treasurer was made in 1930 (Rec. 311). The earliest claim of the United States, matur-

ed September 15, 1932 (Rec. 295). The securities were segregated and set apart from the general assets of the surety company, and deposited with the State Treasurer under a special statute:

> "Policy holders in other states know that those particular funds are segregated from the mass of property owned by the company, and that they cannot look to them to the prejudice of those for whose special benefit they were deposited." Blake vs. McClung supra.

A valid trust has the attribute of inviolability, as the word "trust" signifies. If valid when made, it is impregnable against the assaults of the creditors of the settlor, and even against the creditors of the cestuis que trustent, if so intended and so expressed. The sanctity of a valid trust is as inviolable as the chastity of a good woman. It is equally as binding as against subsequent creditors as the lien of a mortgage or judgment.

A case similar in principle in support of the above argument is that of State ex rel Rankin vs. Wilbaux County Bank, 281 Pac. 341, with which the case of The American Surety Company -vs- Mullendore, and another case were, apparently, consolidated. In this case the American Surety Company as subrogee of the United States, sought to set up a preferred claim against the Receiver of the Bank The asserted right of priority of American Surety Company, as subrogee of the United States, claiming to stand in the same position as the United States, and entitled to the benefits of the priority statute against a stockholders' liability fund, which was collected pursuant to a Montana statute, was denied. An appeal was taken to the Supreme Court of Montana. That Court held in part as follows:

"This right of priority is not an attribute of sovereignty, but depends on the acts of Congress.

The United States has preference in the payment of its debts, by virtue of Section 3466, under any of the conditions mentioned in the section, but not in the distribution of funds which for any reason do not come within the statute. It establishes priority which is limited to the particular state of things specified in the act.

We think it manifest that the provisions of 3466, supra, relate to the property and assets of the debtor, and have no application whatever to a trust fund created by statute, and in which the bank has no interest. The fund collected under Section 6036, as amended is not an asset of the insolvent bank - - - but is a trust fund collected upon the stock for ratable distribution among *all* who are creditors at the date of the bank's failure.

We are of the opinion that the surety company, as subrogees of the United States, have no priority against the funds in the hands of the receiver of the insolvent bank, on account of the stockholders' liability, for the reason that section 3466, supra, does not give them such a privileged position."

A petition by the American Surety Company for certiorari was denied by the Supreme Court of the United States. 281 U. S. 725, 50 Sup. Ct. 239, 74 L. Ed. 1142. See also: U. S. vs. Musselshell State Bank, 60 Fed. (2d) 157, and the cases therein cited.

The Courts have repeatedly held that the Federal priority statute does not disturb prior liens or valid transfers. In

Davis, Director General of Railroads etc. vs. Michigan Trust Co., 2 Fed. (2d) 194, it is said:

> "The claim of the United States to the asserted priority rests exclusively upon the statute. No lien is created by it. It does not over-reach or supersede any bona fide transfer of property in the ordinary course of business."

In Brent vs. Bank of Washington, 10 Pet. 596, 9 L. Ed. 547, it was held that the preference given to debts due the United States does not affect any conveyance or mortgage executed in the ordinary course of business prior to the time the event took place which gave rise to the right of the United States to priority. In Theluson vs. Smith, 2 Wheat. 396, 4 L. Ed. 271, it was held that where the debtor made a bona fide conveyance of his property to a third person, or mortgaged it to secure a debt, or if his property had been seized under an execution before the right of preference to the United States accrued, the right of priority did not exist. See also: Savings & Loan Soc. vs. Multnomah County, 169 U. S. 421, 18 Sup. Ct. 392, 42 L. Ed. 803; Beaston vs. Farmers Bank, 12 Pet. 102, 9 L. Ed. 1017.

In view of the fact that property set aside, dedicated, or conveyed, under a valid trust, is altogether as binding as a mortgage or any other transfer, and in view of the fact that the Federal priority statute does not disturb such conveyances, liens, or transfers, the conclusion must follow that the Federal priority statute would not abrogate nor affect the priorities of the beneficiaries of the trust fund here under consideration.

Question (e): May a Federal Collection Statute Abrogate, Or Set at Naught, a State Statute Enacted in the Exercise of the Police Power of the State? (Prefatory portion of question omitted.)

The Federal priority statute is not an attribute of sovereignty but depends entirely upon the provisions of the Statute. U. S. vs. State Bank, 6 Pet. 29, 8 L. Ed. 308; Mellon, Director General of Rys. etc. vs. Michigan Trust Co., 271 U. S. 236, 46 Sup. Ct. 511, 70 L. Ed. 924.

The rights of the States to legislate generally for the safety and welfare of their citizens were retained in the States. These rights have been zealously guarded by the people and generally upheld by the Courts. The right to legislate for the safety and security of its people, is doubtless the highest attribute of sovereignty. The Federal priority statute might well be considered merely as a collection statute—admittedly supreme in its proper scope and sphere, but that sphere is not to displace and set at naught valid statutes enacted in the exercise of the police power of a State.

It is not difficult to see that if the claims of the United States had been in excess of Seventy-five Thousand ($75,000.00) Dollars, and if the United States had the right of priority of payment out of said deposit, the Florida claimants would have received nothing and the whole purpose of the State legislation would have been thwarted.

In the original brief of petitioner, seeking the writ herein, facts were argued which do not appear upon the face of the record, as follows:

"At the present time there are various funds, which have been deposited by surety companies in different States for the purpose of doing business within the State, in which the United States is claiming priority. In each instance the surety company is insolvent, and most of the companies have very few, if any, assets other than these state deposits. The claims of the United States against these funds aggregate several millions of dollars, and are now being presented in a number of proceedings in the different States.

When the surety companies requested authority of the United States to write bonds in favor of the Government, it was reasonably represented that these state deposits were part of their assets. If a surety company is permitted to deposit the great bulk of its assets in the funds required by the various States, and if the United States is not entitled to participate in the state deposits, the priority established by Section 3466 will in effect have been destroyed in the surety business."

Although the facts stated in the foregoing excerpt from the brief of the petitioner do not appear in the record, yet, undoubtedly, they are true. If we may be granted the same liberty as that taken by the petitioner, may we not also state the converse; that there are certain receiverships of insolvent surety companies pending in Florida wherein the claims of the United States are in excess of the statutory deposit. So that, if the position urging priority taken by the United States is sustained the entire intent and purpose of the Legislature in requiring the deposit by surety companies will be thwarted.

A different situation would have arisen had the Florida Receiver been in possession of *all* of the assets of the surety company. In that event, the right of priority in the United States would have attached as against all assets not embraced in valid and prior mortgages, or trusts, or covered by prior liens. This right of priority doubtless is enforcible against all unencumbered assets of the surety company in the hands of the domiciliary liquidator, to whom by operation of law an assignment of *all* such assets was required under the statute of the State of New Jersey, Chapter 244, Pamphlet Laws 1931 providing in part as follows:

> " - - - - whenever the Commissioner of Banking and Insurance shall ascertain - - - - that any such insurance company is exceeding its powers, or violating the law, etc. - - - said Commissioner may forthwith take possession of the property and business of such company and retain such possession until such company shall resume business or its affairs be finally liquidated as herein provided."

Since, therefore, the United States has an adequate remedy by enforcing its rights of priority against the assets in the hands of the domiciliary liquidator, and since such course would, do no violence to a valid trust fund, leave unimpaired a salutary police regulation of the State of Florida and eliminate the controversy over the sovereign rights of the National and State Governments; and since the United States possesses, within its borders, the attribute of ubiquity, rendering it as easy for it to proceed to enforce its obligations in New Jersey as in Florida, it would seem that all uncertainties, if any, should be resolved against the contentions of the United States herein.

Question (f): Where Congress has Prescribed the Conditions Upon Which a Surety Company May be Accepted as Surety on Surety Bonds Running to the United States, Can the Federal Government Rightfully Rely Upon Statutes Prescribing the Conditions Upon which Surety Companies May Write Bonds within that State, to the End That the Protection Designed by the State Statute for the Citizens of That State, might be Wholly Consumed by the Federal Government?—(Prefatory portion of question omitted.)

We have hereinabove shown that Congress has enacted legislation for the protection of the Federal Government against insolvent and irresponsible surety companies. These statutes offer no protection to the State of Florida nor its citizens. Congress did not undertake to prescribe the conditions upon which a surety company might qualify to transact business in Florida. Therefore, Florida had the right to, and did, legislate on the subject. There was nothing in either of the respective statutes on the subject in the nature of reciprocity. Each Government looked to its own devices until Florida's device proved to be the more effective. Whereupon, the Federal Government sought to appropriate the benefits of the Florida statute minus the conditions thereof.

The Court held in the case of Andrew W. Mellon, Director General of Railroads etc. vs. Michigan Trust Company, 271 U. S., 236, 46 Sup. Ct. 511, 70 L. Ed. 924, and in the case of United State vs. Guaranty Trust Co., 280 U. S. 478, 50 Sup. Ct. 212, 74 L. Ed. 556, that the indebtedness of railroads to the United States, for money advanced

under the transportation Act, was collectible only under the provisions of that Act, and not under the priority statute. In the latter case the Court said:

> "Moreover, Congress evidenced unmistakably its purpose to rely, for obtaining payment of the Government's advances, upon means other than the priority provided for by Section 3466. Under all of the sections, the giving of adequate security was either required or left to the discretion of the President."

In the matter of surety companies, Congress had legislated to secure the United States against loss. (Sections 1 to 11, Title 6 U. S. C. A. supra). For instance, in section 8, Title 6, U. S. C. A., supra, every surety company must furnish a statement, and must have $250,000.00 paid up capital, and the Secretary of the Treasury must grant authority to the surety company to write bonds. Section 9 requires each surety company to file quarterly statements with the Secretary of the Treasury, and gives the Secretary of the Treasury the power and the duty to revoke the authority of any surety company to transact business whenever in his judgment such company is not solvent. It also specifically provides:

> "He may institute inquiry at any time into the solvency of said company and may require that *additional security* be given at any time by any principal when he deems such company no longer sufficient security."

It would seem, therefore, as in the Guaranty Trust Company case, supra, that: "Congress evidenced unmistakably its purpose to rely - - - upon means other than the priority provided by Section 3466."

Question (g): Since the Federal Government's Right of Priority is Wholly Statutory, Must not the Allegations in the Claims of the United States be Such as to Bring Such Claims Within the Protection of the Federal Priority Statute? (Prefatory portion of question omitted.)

The claims of the United States contain the following material allegations (Rec. 157):

1. They claim preference by reason of:

(a) The lien on those certain assets in possession of the Receiver under the judgment obtained by the United States;

(b) Section 3466 R. G. S. of the United States (Title 31 U. S. C. A. 191).

2. The service of summons on the surety company in scire facias proceedings on an estreated bail bond.

3. The rendition of a final judgment on the dates stated.

4. The filing of a written notice with the State Treasurer under Sections 6302 and 6303 C. G. L. of Florida, thereby creating a specific lien on the bonds and securities.

5. That said surety company was by the laws of New Jersey declared insolvent and placed in liquidation on the 28th of May, 1932.

6. That a temporary restraining order issued by the United States District Court for the Southern District of Florida, temporarily restraining the State Treasurer from disposing of said securities, was dissolved by said court.

The following material allegations in the claims are absent:

(a) They do not allege that the "debtor, not having sufficient property to pay all his debts" made a voluntary assignment.

(b) They do not allege insolvency of the debtor within the meaning of Section 3466 R. S.

(c) They do not allege that the debtor's assets were insufficient to pay all its debts.

(d) They do not allege the commission of an act of bankruptcy by the debtor.

(e) They do not allege that the estate and effects of an absconding, concealed or absent debtor were attached by process of law.

(f) They do not allege any conveyance to defraud, or preference through transfer or through legal proceedings, or general assignment for the benefit of creditors.

(g) They do not allege that the creation of the trust fund by the deposit with the State treasurer was in fraud of creditors, or made when the surety company was insolvent, but on the contrary, they show a recognition of the propriety of the making of the deposit by attempting to collect the judgments in conformity with the requirements of the statute requiring the deposit.

(h) They do not show ownership by the debtor of the trust funds in the hands of the Florida Receiver, which the Receiver holds and administers in right of the State of Florida, and by its authority, but recognize the right of the State, through its Treasurer, to retain the same.

(i) The only allegation as to the insolvency of the surety company is contained in Paragraph III (Rec. 158) of

its claims, wherein it is alleged "said New Jersey Fidelity & Plate Glass Insurance Company - - - *was declared* to be insolvent and was placed in liquidation at the close of business on the 28th day of May, A. D. 1934." (Italics supplied).

Failure to make the omited allegations hereinabove set forth is fatal to the contention of the United States that it has a right to priority under Section 3466 R. G. S., as is clearly clearly shown by the decision of the Court in the case of United States vs. Oklahoma, 261 U. S. 253, 43 Sup. Ct. 295, 67 L. Ed. 638. The position of the respondents in the present case is infinitely stronger than the position of the State of Oklahoma in the case of United States vs. Oklahoma, supra, for the reason that in the Oklahoma case it appeared that all of the assets of the Bank had been taken over by the liquidator. It further appeared that no trust fund had been created long prior to liquidation, while, in the case now before the Court, there never has been a taking over of all the assets of the surety company by the Florida Receiver but only the creation of the trust fund long prior to the receivership, against which trust fund the priority statute would not attach even if the allegations had been sufficient to have called into operation the priority statute.

We also desire to call the Court's attention to the allegations in the claims that said surety company "was declared to be insolvent", but that it fails to allege by whom it was declared to be insolvent, and it must be presumed that it was declared to be insolvent by the Commissioner of Banking and Insurance of the State of New Jersey. The Court held in the case of United States vs. Oklahoma, supra, that a determination by the Banking Commissioner

of Oklahoma was not an adjudication of insolvency as contemplated by the Federal priority statute.

In the decision of this Court, in Conrad vs. Atlantic Insurance Company, 1 Pet. 386, 7 L. Ed. 189; United States vs. Howland, 4 Wheat. 108, 4 L. Ed. 526, and in numerous other cases, it was held that the burden is on the United States to show that the debtor made a voluntary assignment of *all* of his property in order for the priority statute to attach. It is submitted that the United States has failed to allege such a state of facts as calls into operation the priority statute.

See Davis, Director General -vs- Michigan, 2 Fed. (2d), 194, and also the case of Mellon vs. Michigan Tr. Co., 46 Sup. Ct. 511, 271 U. S. 236, 70 L. Ed. 924, affirming the Davis case, supra. The above case also holds that the Government's right of priority under Section 3466 over other creditors does not extend to equity proceedings wherein a receiver is appointed, although the circumstances are sufficient to make such appointment an act of bankruptcy. To the same effect is Beaston vs. Farmers' National Bank of Del. 12 Pet. 102, 9 L. Ed. 1017. The proceeding in the instant case is a proceeding in equity wherein a receiver was appointed.

The obligations of the United States herein all arose out of bail bonds, which are purely penal obligations. We insist that they are not "debts due to the United States", as contemplated by the priority statute. Furthermore, the Receiver alleged (Rec. 189, Par. 8) that the judgments of the United States

> " - - - were obtained upon appearance bonds executed in behalf of persons charged with the violation

of the Federal Prohibition laws, and that since the dates of the execution of bonds, the 18th Amendment to the Constitution of the United States, prohibiting the manufacture, sale or transportation of intoxicating liquors, has been repealed, and by reason thereof, all prosecutions of such cases have been abated, and that the abatement of a prosecution under such circumstances and conditions would have, or should have, the effect of rendering unenforcible an appearance bond executed by a defendant charged with the violation of the National Prohibition laws, and would also abate the collection of a judgment rendered on such a bond, since the defendant in such cases, who is the principal in such bond, could not now be required to appear for trial, and for the Court to penalize the innocent surety on a bond, and thereby the creditors of such surety, when it becomes insolvent, would be inequitable and against the spirit and purpose of our laws."

The United States moved to strike the above quoted language from the answer of the Receiver (Rec 195-197, Par. 7 of Motion), thereby admitting said allegations of the Receiver's answer to be true. The motion to strike said portion of the answer of the Receiver was denied in the order of May 28, 1934 (Rec. 201). Therefore, the said allegations were never denied, but were admitted to be true and were retained in the answer although neither the lower court nor the Supreme Court of Florida expressly passed upon said question.

It is too well established to require the citation of authority that the release of the principal releases the surety. Here we have the anomolous situation wherein the credi-

tors of a surety company are penalized when no penalty can be inflicted upon the offender or the principal.

The claims of the United States are pending in a court of equity, which deals with the substance rather than the form, and whose processes can be called into operation by only such considerations as appeal to a court of conscience. The conclusion that the enforcement of these penal obligations against the creditors of an insolvent surety company, when no recourse is available as against the principal, would be inequitable and unjust seems irresistible.

We are not unaware of the holdings of this Court in the case of United States vs. Mack et al, 295 U. S. 480, 55 Sup. Ct. 813, 79 L. Ed. 1559, wherein the [illegible]eld that a bond conditioned upon the return of a vessel seized under the Federal Prohibition law was enforcible even after the repeal of the 18th Amendment. But, it seems that there are several vital distinctions between that case and the instant case. The former was in the nature of a proceeding in rem. The rights of the United States for the confiscation and sale of the vessel accrued and became fixed before the repeal of the law, and at the time the crew of the vessel entered pleas of guilty. At that moment the United States established its right to the confiscation of the vessel. It had a monetary interest in the vessel. In the instant case the bonds were executed to insure the appearance of the defendants in person in criminal cases for trial, and, upon conviction, to receive the punishment of the Court. There was no monetary consideration involved, but merely the enforcement of a criminal statute. The United States, in the absence of the 18th Amendment to the Constitution, conferring the power upon Congress to prohibit the manufac-

ture, transportation and sale of intoxicating liquors, was without any power in the premises. When this fundamental grant of power was taken away by the repeal of the Amendment, the United States was left utterly without any authority whatsoever. It would seem that if this is true the United States could not call into operation the processes of a court of equity to now enforce penalties provided by a law that no longer exists.

We submit, therefore, that even if we are in error in every other argument herein sought to be presented, and even if we disregard the trust fund feature of the State statute, and even if we consider the assets in the hands of the Florida Receiver as being general assets, yet, the United States, under the showing made, is not entitled to have the benefit of the Federal priority statute.

CONCLUSION

For the above considerations we, therefore, respectfully submit that the decision of the Supreme Court of Florida in this cause should be affirmed.

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APPENDIX

Section 3466 of the Revised Statutes of the United States (U. S. C., Title 31, Sec. 191):

> Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

Section 6302, Compiled General Laws of Florida:

> *Requirements to do business in this State*—Companies herein described, chartered by this State, or other States or foreign Governments, now doing business in this State, or hereafter doing business in this State, which offer or undertake to become surety upon any bond, or surety contract, before being accepted as surety thereon, shall be required to deposit with the Treasurer of this State bonds of the United States, or bonds of any State of the United States, and which amount according to their market value, to seventy-five thousand dollars which bonds shall be receipted for by the State Treasurer and held or deposited by him. And whenever such company ceases to do business in this State, and has settled up all claims against it, as hereinafter provided, and has been released from

all the bonds upon which they have been taken as sureties said bonds shall be delivered up to the proper party on presentation of the Treasurer's receipt for said bonds. While said bonds are so deposited with the Treasurer, the owner of the same shall be entitled to collect the interest on the same. For the bonds so deposited, the faith of the State is pledged that they shall be returned to the party or parties entitled to receive the same.

Section 6303, Compiled General Laws of Florida:

Final judgment against surety company.—Whenever final judgment has been rendered against any surety company on a fidelity or surety bond, said surety shall pay the same within thirty days. Upon notice of failure to pay said amount within said time, the State Treasurer shall retain said bonds, or so much thereof as may be necessary to cover said judgment and costs, subject to the order of the court trying any suit that may be brought upon such bond.

Chapter 16248, Laws of Florida, 1933:

SECTION 1. That Section 4340 of the Revised General Statutes of Florida of 1920, the same being Section 6303 of the Compiled General Laws of Florida 1927, be and the same is hereby amended to read as follows:

"6303 (4340) FINAL JUGMENT AGAINST SURETY COMPANY.

"Whenever a final judgment has been rendered against any surety company on a fidelity, appearance, supersedeas or surety bond, the surety on said bond shall pay the same within thirty days. Upon notice

of failure to pay the amount due under said bond within said time, the State Treasurer shall retain the bonds or securities deposited with him by said surety company under Section 4339 of the Revised General Statutes of Florida of 1920, and acts amendatory thereof, or as much thereof as may be necessary to cover said judgment and costs, subject to the order of the Court trying any suit that may be brought upon said bond: Provided, however, that in the event of the adjudication of insolvency of any such surety company by a court of competent jurisdiction, or in the event its assets should be placed in liquidation in the State of its incorporation, the Court of Chancery, at the seat of Government in Florida shall have jurisdiction, upon bill filed by any party in interest, to take charge of the securities so deposited with the State Treasurer under the provisions of Section 4339 of the Revised General Statutes of Florida of 1920, and acts amendatory thereof, together with any other assets of such surety company, which may be marshaled in the State of Florida, to direct a sale of the said securities at public or private sale and on such terms as the said court deems proper and, after paying all costs and expenses, including reasonable counsel fees incurred in connection with said proceedings, all as allowed by the court, to distribute the proceeds of the sale of said securities proportionally among all of the Florida creditors who may make proof of their claims against any such surety company to the satisfaction of said court, the surplus, if any, to be disposed of by proper order of such court. The said court is empowered to ascertain, as far as practicable, the names and addresses of all Florida creditors and the amounts due

and owing to them under bonds given by said surety company, and to notify the Florida creditors to make proof of their claims and to determine the validity and the amount due each of them. The claims of all Florida creditors of any such surety company not reduced to final judgment prior to the time the said Court of Chancery takes charge of such Florida assets shall participate in the proceeds of the sale of said securities and assets only on a proportional basis with other Florida creditors. Upon the said Court of Chancery assuming jurisdiction of the said securities and assets of such surety company, all actions against the said company and the said securities and assets shall be stayed, pending the further orders of said Court and the State Treasurer, and the State of Florida shall thereby be absolved from any further liability on account of said securities, and the right of said surety company to transact business in this State shall cease and determine.

"SECTION 2. All laws and parts of laws in conflict with this Act are hereby repealed.

"SECTION 3. This Act shall take effect upon becoming a law.

"Approved May 10, 1933."